ROCKING CHAIR TRUCKSTOP, INC. 410 HIGHWAY 80 SPUR CUBA, AL 36907-9503,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE ADMINISTRATIVE LAW DIVISION
Taxpayer,	§	DOCKET NO. S. 10-176
v.	§	
STATE OF ALABAMA DEPARTMENT OF REVENUE.	§	

OPINION AND PRELIMINARY ORDER ON TAXPAYER'S APPLICATION FOR REHEARING

The Department audited the Taxpayer for State and local sales tax for February 2005 through May 2008. The Department subsequently entered preliminary assessments against the Taxpayer. The Taxpayer petitioned for a review of the preliminary assessments, and a telephone conference was conducted on June 24, 2009. The Sales and Use Tax Division Assessment Officer addressed the Taxpayer's arguments in a December 29, 2009 letter to the Taxpayer's representative. The Department subsequently entered State and local final assessments against the Taxpayer on January 11, 2010 for $60,561.54 and $3,634.57, respectively, which included the 50 percent fraud penalty and applicable interest. The Taxpayer timely appealed to the Administrative Law Division.

A hearing was conducted on June 1, 2010. The Taxpayer's representative indicated at the hearing that the Taxpayer had additional records for the Department to review. The representative submitted the records to the Administrative Law Division on July 7, 2010, and they were forwarded to the Department for review.

The Department adjusted the Taxpayer's liabilities and responded on April 22, 2011 that the State and local final assessments should be reduced to $51,626.57 and $2,368.13, respectively. The Taxpayer responded on June 14, 2011 with various objections to the

Department's adjustments. The Department addressed the Taxpayer's objections in a June 27, 2011 memorandum. The Administrative Law Division subsequently entered a Final Order on June 30, 2011 reducing the State and local final assessments to $51,626.37 and $2,368.13, respectively, plus applicable interest.

The Taxpayer timely applied for a rehearing on July 13, 2011 and reiterated its objections to the Department's audit. It later filed a supplemental response, arguing that the final assessments should be dismissed based on the doctrine of laches because the Department took over nine months to respond after the Taxpayer submitted additional records in July 2010.

The Administrative Law Division entered a Fifth Preliminary Order on Taxpayer's Application for Rehearing on March 28, 2012. The Order rejected the Taxpayer's laches argument, but indicated that the matter would be submitted to the Department's Taxpayer Advocate to determine if any accrued interest should be abated due to undue Department delay. See, Code of Ala. 1975, §40-2A-4(b)(1)c.

This case is a textbook example of why a retailer is required by law to keep complete and accurate cash register tapes, purchase invoices, and other relevant records from which the Department can accurately compute and verify the retailer's sales tax liablity for a given period. The Taxpayer in this case failed to do so, and the result is an audit/assessment/appeal process that has lasted almost four years.

The primary and most reliable method of recording sales is with a cash register z-tape. The Taxpayer failed to provide the Department with any z-tapes for the audit period. Rather, the Taxpayer provided a daily/monthly sales log or journal. The Taxpayer's tax preparer had used the sales journal to compute the Taxpayer's monthly sales tax returns.

The problem with using a sales journal is that there are no underlying records supporting the sales amounts recorded in the journal. As stated by the Department examiner in her audit report, Dept. Ex 3, at 2 – "It is not clear where taxpayer derived the sales amounts that were posted in the daily log . . . . No register tapes or other documentation was provided to verify the amounts posted to the log."

The Taxpayer did provide some purchase invoices for 2005 and 2006. The examiner determined that the Taxpayer's purchase invoices were incomplete. She obtained purchase information from two of the Taxpayer's major vendors and "found that more than $368,000 in purchases from the two major suppliers were missing from the two years where invoices were provided." Dept. Ex. 3, at 2.

The examiner thereafter computed the Taxpayer's liability using a purchase mark-up audit. She used the 2005 and 2006 purchase information from the two major vendors to estimate the Taxpayer's purchases in 2007 and 2008 because the Taxpayer failed to provide purchase information for those years. The standard IRS mark-up of 35 percent for convenience stores and 168 percent for restaurants was then applied to total purchases to determine total sales during the period. Sales tax due was computed on total sales, and a credit for tax previously paid was allowed to determine the additional tax due. A 50 percent fraud penalty was also added.

All taxpayers are burdened with the affirmative duty of maintaining adequate records from which their correct tax liablity can be accurately computed and/or confirmed by the Department. Code of Ala. 1975, §40-2A-7(a)(1). If a taxpayer fails to provide the Department with adequate records, for whatever reason, the Department is authorized to "calculate the correct tax . . . based on the most accurate and complete information

reasonably obtainable." Code of Ala. 1975, §40-2A-7(b)(1)a.

As indicated, the Department used a purchase mark-up audit to compute the Taxpayer's liability in this case. A purchase mark-up audit is a simple, oft-used Department method of determining a taxpayer's sales tax liability where the taxpayer fails to keep accurate sales records. See generally, *GHF, Inc. v. State of Alabama*, S. 09-1221 (Admin. Law Div. 8/10/10); *Thomas v. State of Alabama*, S. 10-217 (Admin. Law Div. O.P.O. 5/18/10); *Alsedeh v. State of Alabama*, S. 03-549 (Admin. Law Div. 11/3/04); *Arnold v. State of Alabama*, S. 03-1098 (Admin. Law Div. 7/27/04); *Moseley's One Stop, Inc. v. State of Alabama*, S. 03-316 (Admin. Law Div. 7/28/03); *Pelican Pub & Raw Bar, LLC v. State of Alabama*, S. 00-286 (Admin. Law Div. 12/15/00); *Joey C. Moore v. State of Alabama*, S. 99-126 (Admin. Law Div. 8/19/99); *Robert Earl Lee v. State of Alabama*, S. 98-179 (Admin. Law Div. 6/28/99).

Vendor records are the best and most accurate source in determining a retailer's wholesale purchases for purposes of a purchase mark-up audit. The Department is also statutorily authorized to use those "most accurate and complete" records in computing the retailer's sales tax liablity, "and the taxpayer, having failed in the duty to keep good records, cannot later complain that the records and/or method used by the Department is improper or does not reach a correct result." *Jones v. C.I.R.*, 903 F.3d 1301 (10th Cir. 1990); *State v. Ludlum*, 384 So.2d 1089 (Ala. Civ. App.), cert. denied, 384 So.2d 1094 (Ala. 1980) (A taxpayer must keep records showing the business transacted, and if the taxpayer fails to keep such records, the taxpayer must suffer the penalty of noncompliance.) *Melton v. State of Alabama*, Docket No. S. 10-376 (Admin. Law Div. 11/4/2010) at 7.

The Taxpayer's representative did as good as job as possible in representing the

Taxpayer in this case. Unfortunately, as discussed, he was hampered by the Taxpayer's failure to keep cash register tapes or other good sales records. The Department has several times reviewed and addressed the records and arguments that were submitted and sometimes resubmitted by the Taxpayer, and it reduced the Taxpayer's liabilities as it deemed appropriate. Although the Taxpayer's representative still disagrees with portions of the audit, I find no evidence that the tax and interest due, as last reduced by the Department in February 2012, should be further reduced. The State sales tax and interest due is $29,652.58 and $5,934.76, respectively, computed to January 11, 2010, and the local tax and interest due is $905 and $183.84, respectively, also computed through January 11, 2010.

The Department assessed the Taxpayer for the fraud penalty because the Taxpayer substantially underreported during the subject period and failed to keep adequate sales records. Those facts do support a finding of fraud, but those facts are not conclusive.

Importantly, the Taxpayer hired and relied on a competent, honest tax preparer to do his taxes. I understand that a tax preparer is only as good as the information he or she is provided by a taxpayer, but the experienced preparer in this case believed in good faith that the information provided to him by the Taxpayer's owner was sufficient. Under the circumstances the 5 percent negligence penalty at Code of Ala. 1975, §40-2A-11(c) should apply in lieu of the fraud penalty.[1] The applicable State penalty is 5 percent of $29,652.58, or $1,482.63. The applicable local penalty is 5 percent of $905, or $45.25.

[1] The Taxpayer's owner is on notice that he must maintain complete and legible cash register tapes, complete purchase invoices, and other records from which the Department can compute and verify his correct sales tax liability. The fraud penalty may apply in the future if he fails to do so.

A copy of this Order has been submitted to the Department's Taxpayer Advocate for a determination as to whether a portion of the interest that has accrued after the entry of the final assessment should be abated due to Department delay, see page 2 above. An appropriate Final Order will be entered after the Advocate responds.

This Opinion and Preliminary Order is not an appealable Order. The Final Order, when entered, may be appealed to circuit court within 30 days pursuant to Code of Ala. 1975, §40-2A-9(g).

Entered July 13, 2012.

_____
BILL THOMPSON
Chief Administrative Law Judge

bt:dr
cc: Margaret Johnson McNeill, Esq.
Stephen H. Schniper
Gregory Yaghmi, Esq.
Joe Walls
Mike Emfinger
Brenda Russ (w/enc.)